Topeka Exhibit No. _____

BEFORE THE KANSAS CORPORATION COMMISSION
OF THE STATE OF KANSAS

STATE CORPORATION COMMISSION

MAY 0 2 2001

Docket Room

Docket No. 01-WSRE-436-RTS

PREPARED SURREBUTTAL TESTIMONY

of

EDWARD C. BODMER

ON BEHALF OF
THE CITY OF TOPEKA, KANSAS

May 2, 2001

STATE OF KANSAS
BEFORE THE STATE CORPORATION COMMISSION

.02 15:56:27
Kansas Corporation Commission
/S/ Jeffrey S. Wagaman

Before Commissioners: John Wine, Chair
Cynthia L. Claus
Brian J. Moline

WESTERN RESOURCES, INC. and KANSAS GAS AND ELECTRIC COMPANY, INC.	))))))	**Docket No. Ol-WRSE-436-RTS**

SURREBUTTAL TESTIMONY OF EDWARD C. BODMER

I. Introduction and Summarv

Q. Please state your name and address.

A. Edward C. Bodmer, 59.51 Oakwood Drive, Lisle, Illinois.

Q. Are you the same Edward C. Bodmer who filed Direct and Cross Answering Testimony in this matter?

A. Yes, I am.

Q. What is the purpose of your surrebuttal testimony?

A. I respond to various critiques of adjustments described in direct testimony made by witnesses that Western has sponsored. I begin by commenting on the testimony of Mr. Leslie Morgan relating to my “energy value” adjustment. Second, I discuss testimony on my “levelization” approach to capital recovery for the Stateline plant made by Western’s witnesses Dr. Charles Cicchetti and Mr. Kelly Harrison. Third, I

consider the testimony of Mr. Richard Dixon and Mr. Kelly Harrison regarding my transmission expense adjustment. Fourth, I review the testimony of Mr. Charles Hodson regarding my adjustment associated with the shareholder option value generated by dual fueling capability. Finally, I comment on testimony submitted by Mr. Aikman regarding my adjustment to the depreciation rate for the Gordon Evans combustion turbine units.

Q. Has the testimony sponsored by the various Western witnesses convinced you to retract any adjustments that you made in your direct testimony from a logical perspective?

A. No. Suggestions made by Western that my adjustments are “speculative”, “erroneous”, based on “false inferences” or “absurd” are wrong. Western’s witnesses have made no convincing arguments that the logic of my direct testimony was incorrect. However, information that Messrs. Morgan, Harrison, Loos have provided, which was not previously available to me, implies that adjustments concerning energy value and levelization of Stateline capital recovery should be revised.

Q. Describe revisions in the dollar amount of your adjustments?

A. Testimony submitted by Mr. Leslie Morgan regarding the expected heat rate of Stateline (and similar statements made by Western in a revised data request response with respect to Gordon Evans and Stateline) have caused me to revise the energy value adjustment. Using the heat rate data that was not available to me when I filed my direct testimony, along with test year market prices for purchased power and off-system sales, causes the adjustment to increase by $669,252 (from $10.297 million to $10.966 million).

Testimony submitted by Mr. Kelly Harrison and Mr. Larry Loos regarding interim additions at the Stateline plant has caused me to revise my levelization adjustment. These witnesses imply that the effective life of Stateline should be 20 years rather than the 35 years I used in the direct testimony. Using the 20 year life instead of a 35 year life reduces the dollar amount of the adjustment by $1.95 million (the adjustment

was $6.620 million, and it is now $4.695 million). The shorter life implies that Western still recovers about 67 percent of Stateline capital recovery in the first seven years using Western's cost of capital and capital structure assumptions. However, the 67 percent recovery is relative to the lease term which covers 35 percent of the plant life on the adjusted life basis.

The effects of revisions to my proposed adjustments are shown on Schedule ECB-5. Using Western's proposed cost of capital and capital structure for purposes of levelizing Stateline capital recovery, the two revisions imply that my adjustments total $21.8 million rather than $22.9 million shown in the original Schedule _ECB-1 to my direct testimony. If the KCC staffs cost of capital and capital structure is used in levelizing Stateline capital recovery costs, the adjustments total $23.5 million as shown on page 2 of Schedule ECB-5.

II. Energy Value Adjustment

Q. What is the primary criticism that Mr. Leslie Morgan makes with respect to your energy value adjustment?

A. He states that my adjustment is speculative. Some of the comments Mr. Morgan made in his rebuttal testimony include:

1. "to make speculative adjustments beyond the test year would be wrong."
2. "as the Companies' oppose decreasing their revenue requirement based on speculation concerning increased off-system sales"
3. "the events about which Mr. Bodmer speculates and which form the basis for Mr. Bodmer's proposed adjustment can increase costs or income to the Companies."
4. "Such speculative adjustments do not form an appropriate basis for setting rates."
5. "There is no need for Mr. Bodmer to speculate on the future and incorporate these energy value calculations."

Q. Review the mechanics of your energy value adjustment.

A. I used actual hourly market price data provided by Western and computed the value that the Stateline plant and the Gordon Evans combustion units would have provided to customers had these plants been in operation during the test year, at test year market prices and test year fuel costs. The dollar amounts in the adjustment do not use any market price data other than actual test year values. The variable cost of the units reflects actual natural gas price data provided by the Energy Information Agency for the test year. (Mr. Morgan states that I "use market prices from 1998 and 1999." In fact, the adjustment was based entirely on test year data.)

Q. Is there uncertainty with respect to whether actual energy values in future years will be more or less than the amounts you have calculated?

A. Yes. There is uncertainty with respect to the value of the energy produced by the new plants just as there is uncertainty with respect to fuel expense, operation and maintenance expense, sales volumes, off-system sales revenues, purchased power costs and very many other items in the rate case. The variation around my adjustment to energy value is not more than dispersion for many of these other items, and most importantly, there is no bias in my adjustment that favors ratepayers.

I did present data in my direct testimony on the amount that the adjustment would have been had market price data for 1998 or 1999 been used. This information demonstrates that the adjustment would have been larger -- more favorable to ratepayers -- using non-test year market prices. The 1999 and 1998 analysis presented in my direct testimony confirms that there is no bias in my adjustment that is unfavorable to Western shareholders.

Q. Is the estimate of zero for energy value – as proposed by Western -- biased?

A. Yes. The energy value attributable to ratepayers can only be zero if the plants do not operate at all. The existence of new plants can only make Western's system operate more efficiently from an energy production perspective. There is no way the new

plants can make things worse, because Western could in theory simply choose not to operate the plants. As Mr. Morgan states, "without the new resources . . . KPL customers would have . . . increased costs from purchases in the wholesale spot market."

Q. If there is too much uncertainty surrounding the energy value, does the commission have other options with respect to capital recovery costs associated with the new units?

A. Yes. The Commission could disallow the capital recovery costs imposed by the units as well as the energy value benefits. Western asks ratepayers to pay significant capital recovery costs associated with the new plants but not to realize any dollar benefits. It is as if Western asks ratepayers to make payments for a new car and then it does not allow them to receive benefits from driving the car because the miles per gallon statistics are too speculative. If one cannot receive the benefits of driving a car, one should not be responsible for making car payments.

Q. Do you, as Mr. Morgan suggests, think that "the Companies' off-system sales are a bad thing, which create "excessive" profits?"

A. **No.**

Q. Do you "claim" that the Empire sale was "imprudent" as Mr. Morgan suggests?

A. **No.**

Q. Mr. Morgan states that the heat rate I quoted for Stateline in my adjustment was too high. Describe the revised heat rates?

*****CONFIDENTIAL*****

*****CONFIDENTIAL*****

Q. Is there some kind of inherent bias in the test year data that is unfavorable to Western from an off-system sales and fuel cost perspective?

A. No, just the opposite. The test year had relatively low market prices and Western is a net seller rather than a net purchaser. If market prices from another time period had been used for purpose of measuring off-system sales, the credit for off-system sales revenues would have been larger. Western makes adjustments for increased fuel costs and Mr. Morgan discusses increased coal costs, but the company makes no off-setting adjustment for increased off-system sales revenues that occur with higher energy prices.

Q. Is Mr. Kelly Harrison's testimony regarding variable operation and maintenance associated with Stateline correct?

A. No. Variable O&M is already included in the energy value analysis and should not be double counted.

III. Levilized Capital Recovery for Stateline

Q. How do Western witnesses criticize your approach to levelizing capital recovery costs associated with the Stateline plant?

A. Dr. Charles Cicchetti presents some mathematical calculations designed to show if revenue requirements are levelized on a real basis, and if there is a rate case every year, customers would pay the same amount on a present value basis whether capital recovery amounts are levelized or whether traditional rate base treatment is applied. Mr. Kelly Harrison states that my recommended adjustment is inappropriate because "the fact is, the purchased power agreement is for seven years not 35." He also states that I make "the unrealistic assumption the plant will last for 35 years without the normal capital expenditures required to keep the plant running that long." Mr. Harrison also strongly disputes that the Company will recover 67 percent of the capital recovery associated with Stateline in the first seven years of its operation

under Western's proposed ratemaking treatment.

Q. Is Dr. Cicchetti's analysis relevant to your levelization adjustment?

A. No. Rate cases do not occur every year and the Western contract for Stateline capacity is for seven years, not the full expected life of the unit. Dr. Cicchetti acknowledges that front-end loading occurs when costs are measured in the early years of a plant's life. Because rate cases are infrequent, this means front loading would provide Western's shareholders with returns above the cost of equity (see page 18 of my direct testimony). I agree that costs should be levelized, but they must be levelized on a real basis over the life of the plant and not on an artifical truncated basis that allows the Company to earn high returns over the liftime of the plant.

Q. Does Dr. Cicchetti's analysis account for the seven year purchased power contract term and the potential for Western to earn returns on a merchant basis after the initial contract has expired?

A. **No.**

Q. How do interim additions affect the appropriate capital recovery for the Stateline plant?

A. Mr. Larry Loos, a witness sponsored by Western in rebuttal, asserts that because of interim capital additions, the depreciation rate should be 4.93 percent which implies Stateline has a life span of about 20 years. If Western's proposed cost of capital and capital structure is applied, the shorter life suggests that the adjustment to levelize Stateline costs over the life of the plant on an inflation adjusted basis results in a dollar captial recovery amount of $12.2 million. The shorter life still implies that 67 percent of capital recovery costs are recovered in the first seven years of the plant's operation under Western's proposal. However, since a 20 year life instead of a 35 year life is used, the 67 percent compares to 35 percent of the plant life and not 20 percent discussed in my direct testimony. My calculations levelized costs with different life assumptions are shown in Schedule-ECB-6.

Q. What is the impact of computing levelized capital recovery using cost of capital and capital structure assumptions recommended by the KCC Staff?

A. If a return on equity of 10.4 percent is assumed along with a debt to capital ratio of 55.9%, the dollar size of the downward adjustment increases by $1.79 million to $10.43 million. Calculations that support this dollar figure are shown on Schedule-ECB-6.

Q. Mr. Kelly Harrison and Mr. Richard Dixon suggest that your adjustment to transmission is founded upon a misconception of the relationship between the SPP Tariff and the net transmission cost of Stateline. Is your testimony based on such a misconception?

A. No. My testimony is that without Stateline, the SPP regional tariff would not be beneficial <u>and also</u> that additional transmission costs associated with the geographic location of the Stateline plant should not be borne by ratepayers.

Q. Clarify why burdening ratepayers with transmission costs associated with the geographic location of Stateline is inappropriate in the absence of the SPP regional tariff.

A. On page 42 of my direct testimony, I explained that Western has not presented evidence that the geographic site of the plant offers benefits to retail ratepayers. Further, I stated that the geographic location of the Stateline plant may provide off-system sales benefits to Western shareholders. Finally, since Stateline is purchased from the Empire control area, it is unfair that transmission revenues received from Empire Electric in a capacity sale are not credited to ratepayers. Western proposes to charge ratepayers for capacity purchased from the Empire control area and not to credit ratepayers for transmission revenues received from the same control area.

Q. Is the imposition on retail ratepayers of costs associated with the SPP regional tariff justified for reasons other than benefits associated with the Stateline plant?

A. No. I explained in my direct testimony that added costs of the SPP tariff have not

been justified from a ratepayer perspective by off-setting benefits. These benefits that do not accrue to ratepayers and which have not been reflected in the Western proposal include:

1. Lower cost of purchased power (see my direct testimony at page 40).
2. Credits from SPP to reflect the fact that physical transmission assets have not increased (see my direct testimony at page 40-41).
3. "First mover" benefits to SPP that accrue to companies other than Western (see my direct testimony at page 41).

In addition, I note that Western gives very little credit to retail ratepayers for transmission wheeling revenues that it receives. These revenues are a significant reason that -- using Dr. Cicchetti's proposed capital structure -- KPL's actual return on equity for its wholesale operations in the test year was 27.6% compared to the return on equity for retail operations of 17.7%. KPL's overall return on equity using Dr. Cicchetti's capital structure of 47% debt was 18.5%, excluding power marketing profit margins.

Q. Is Mr. Dixon correct that off-setting benefits to the SPP tariff are inappropriate because the "are impossible to estimate with any degree of accuracy. They are not known and measurable?"

A. No. Ratepayers are being asked to pay additional transmission costs in order to receive savings. If savings are somehow too speculative to include in the test year, ratepayers should not be asked to pay those costs that result in the unquantifiable savings. Simply stated, the assumption of zero savings is just as speculative as any other savings estimate. Indeed, the assumption of zero is not only speculative, but it is biased.

To illustrate problems with Mr. Dixon's implication that "speculative" benefits should be ignored, assume there is a wide variation in savings that could arise from conversion to the SPP tariff and that the savings could be anywhere from $.75 million to $6 million. Mr. Dixon would have the ratepayers be responsible for costs of $3.5 million that are incurred for realizing the savings, but because there is a large

standard deviation in the realization of actual savings, he suggests that an estimate of zero, which is outside of the range should be used. This position is unfair. There are two solutions to the problem of uncertainty with respect to savings estimates: (1) eliminate the costs that generate the savings, or (2) make an unbiased estimate of the expected level of savings. In the case of transmission, the costs of the SPP tariff that supposedly are incurred to realize the savings should be eliminated.

IV. Shareholder Options Associated with Dual Fueling Capacity

Q. How does Western respond to your suggestion that shareholders receive benefits from the option to burn natural gas or oil at the Gordon Evans combustion turbine units and therefore shareholders should be allocated the added capital costs?

A. Western has sponsored the testimony of Mr. Charles Hodson who seems to disagree with my adjustment.

Q. Does Mr. Charles D. Hodson agree that dual fuel firing capability at Gordon Evans benefits shareholders in light of the fact that the company has no fuel adjustment clause?

A. He apparently does not. With respect to my adjustment, Mr. Hodson testifies: "Obviously Mr. Bodmer clearly does not understand electric plant operations or he would not make such an absurd statement."

Q. Has the Company's explanation of why it choose to make expenditures for dual fuel capability changed between its direct case and its rebuttal case?

A. Yes. In direct testimony, a witness sponsored by the Company, Ms. Natalie Roth discussed "price stability" as a reason the Company chose to incur added costs for dual fuel capabilities. Now, in rebuttal, no reference is made to price stability and the rationale for dual fuel firing was supposedly only physical reliability during the winter season.

Q. Why does price stability benefit shareholders rather than ratepayers?

A. Western has purchased an option to burn either oil or natural gas. This option has no value to ratepayers in the rate case because the option was not exercised during the test year. Since the dual fuel option benefits shareholders and not ratepayers, an adjustment is appropriate. (If a fuel clause existed, value from exercise of the option would be realized by ratepayers. However, without a fuel clause, shareholders rather than ratepayers receive value when the option is exercised.)

Q. Mr. Hodson states that "Mr. Bodmer's suggestion that these units did not burn oil during the test year is wrong. The units did test burn oil for vendor acceptance or have since test burned oil for vendor acceptance and other unit testing." What is the basis for your statement that the unit did not burn oil?

A. I referred to a document produced by Western in response to data request KGE 067. On this document the page titled "Production Data – 2000" for the Gordon Evans Center CT's contained no oil usage in January through September.

Q. Has Mr. Hodson presented any analytical evidence on the need for the units to have dual fueling capacity for physical reliability purposes during the winter?

A. **No.**

V. Depreciation Rates on Gordon Evans Combustion Turbines

Q. Mr. Aikman states that you "only to refer to the ground lease in determining his depreciation rate for KPL's new generators at Gordon Evans." Is this correct?

A. No. In my direct testimony I discuss a number of reasons for using a 35-year life for the Gordon Evans combustion turbines. This discussion included the following:

1. The Company has strong incentives to apply a high depreciation rate on generating plants (see my direct testimony at page 19-20).

2. Existing turbines owned by Western have an expected life of at least 35 year life without large capital additions (See my direct testimony at Page 29).
3. KPL is not responsible for decommissioning the plant (See my direct testimony at Page 30).

Q. Did you request the Company to provide information on the expected retirement dates for its existing combustion turbine units?

A. Yes. In data request number 32, the City of Topeka asked Western to "Provide the expected retirement date for each combustion turbine owned by KPL and KGE." The Company's response was "Please see Mr. Aikman's testimony and exhibits for answers to these questions." However, Mr. Aikman's testimony and workpapers did not provide specific retirement dates for existing combustion turbines.

Q. Mr. Aikman states that "The length of the ground lease is irrelevant. The fact that it is 35 years may reflect numerous facts not considered in this proceeding including additional units at the site.. ." Is the notion of signing a lease for 35 years to cover the possibility of additional units reasonable?

A. No. Given the ground lease agreement is with an affiliated entity, it makes sense for the term of the lease to cover the expected life of the unit. If additional turbine units were added, an additional agreement could easily be signed. It is not reasonable to pay for a 35 year agreement if there is a possibility that the payment for the last ten years of the agreement will be a waste of money, when you could just as easily have signed a shorter agreement. It would be far more reasonable to sign a 25 year lease and sign a new agreement when new plants are sited.

Q. Did Mr. Aikman quantify the effects of interim additions on the depreciation rate for the Gordon Evans combustion turbine units in his direct testimony?

A. No. Mr. Aikman simply mentioned a "life span" of 25 years and he did not quantify interim additions for the "other production" category.

Q. Does this conclude your surrebuttal testimony?

A. Yes.